8/16/88 R5650-2

JAPAN · ECONOMIC · INSTITUTE

JEI REPORT

A Two-Part Report: A and B

No. 31B
August 12, 1988

IN THIS ISSUE:

Japan Focuses On Insider Trading 1

Mergers Increasing In Japan 4

Japan Continues To Whittle Down Current Account Surplus 5

Takeshita Prepares For China 7

Trade Bill Sent To President 9

Racial Insensitivities In Japan Spark U.S. Anger 11

Aviation Talks Remain Grounded 12

Notes: Aegis Sale 14

Japan Focuses On Insider Trading

A series of scandals involving questionable stock transactions has focused Japanese attention on the structure of domestic financial institutions and trading practices. The Ministry of Finance and the Japan Securities Dealers Association are considering tougher controls on the sale of listed and unlisted shares as well as the creation of stronger oversight and enforcement bodies. As securities firms institute internal safeguards against insider trading, observers wonder if they will be effective without a complete revamp of the nation's financial and industrial structure.

Japan has been rocked by three stock-related scandals within the past 12 months.

However, a survey by the daily Nihon Keizai Shimbun hints that, on balance, competitive conditions appear to be changing little. In 100 key products and services, the leading firm changed in five business lines last year, down from seven in 1986, but up from four each in 1984 and 1985. The newspaper's three-firm concentration ratio (the percentage of an industry's output accounted for by the three largest producers) declined in about as many industries as it increased. Industries producing beer and detergents, two supposedly mature products where market shares are normally stable, saw dramatic changes as new products -- concentrated detergents and dry beer -- boosted the share of the innovators. If instability of leading firms and low concentration ratios indicate competitive vigor, these data suggest little change in 1987 compared to 1986.

Restructuring, of course, is an ongoing process. As Japanese firms continue to adjust to changes at home and abroad, competitive conditions also will change. Whether increases and decreases in competition in specific industries will cancel out over the whole economy remains an open question.

Douglas Ostrom

Japan Continues To Whittle Down Current Account Surplus

Slow but steady. That phrase has become the stock description of Japan's progress in reducing its huge current account surplus. The balance in merchandise trade, services and transfers has been contracting by $2.5 billion to $3.6 billion a quarter on a year-to-year basis since July-September 1987, including a drop of $3.4 billion in this year's April-June period (see Table 1). Analysts caution, however, that headway from now on could be measured in millions of dollars instead of billions.

Simple arithmetic alone yields this possibility since the starting point for future drops in the current account surplus will be the reduced numbers of the last four quarters. But there is another factor at work. Exports in dollar terms are expanding at a faster pace because of an upturn in volume, while the growth of purchases from abroad, although still robust by any definition, seems to be losing a little steam (see JEI Report No. 29B, July 29, 1988). Japan's trade surplus, in short, could increase -- if not in the current quarter, then in the October-December period -- if recent trends hold up. A bigger deficit in services will counterbalance this development but only partly since the greater red ink expected in the travel and passenger transportation category will be offset to a large extent by the continuing jump in net investment income.

The prospect of a slowdown in the already snail-paced progress of trimming the current account surplus or even an end to this process is certainly unsettling for Japanese government officials and business leaders counting on a smaller black-ink figure to dampen protectionist sentiment here and in Europe. What interests their American counterparts, though, is the amount of Japanese long-term capital moving overseas in coming months. Forecasting the outlook for direct investment is simple since there is nothing on the horizon that should prevent a repeat of the results in 1988's first half, when Japanese investment in offshore manufacturing, banking, real estate and other activities was running at nearly twice 1987's record-setting pace.

Table 1: Japan's Balance of Payments

(in millions of dollars)

	Trade Balance	Exports (f.o.b.)	Imports (f.o.b.)	Services (net)	Current Account Balance	Long-Term Capital (net)
1983	$31,454	$145,468	$114,014	$-9,106	$20,799	$-17,700
1984	44,257	168,290	124,033	-7,747	35,003	-49,651
1985	55,986	174,015	118,029	-5,165	49,169	-64,542
1986	92,827	205,591	112,764	-4,932	85,845	-131,461
1987	96,386	224,605	128,219	-5,702	87,015	-136,532
1986:I	14,552	44,813	30,261	-1,145	12,668	-18,990
1986:II	23,922	52,270	28,348	-374	23,099	-28,882
1986:III	26,793	53,859	27,066	-1,922	24,413	-38,410
1986:IV	27,560	54,649	27,089	-1,491	25,665	-45,179
1987:I	23,373	50,515	27,142	-1,348	20,962	-32,209
1987:II	25,038	55,823	30,785	-1,601	22,762	-44,365
1987:III	23,585	56,600	33,015	-1,757	21,189	-22,023
1987:IV	24,390	61,667	37,277	-996	22,102	-37,935
1988:I	21,021	59,345	38,324	-1,337	18,421	-15,142
1988:II (p)	22,471	63,409	40,938	-2,133	19,333	-36,353

Table 2: Japan's Net Purchases of Foreign Securities

(in millions of dollars)

	Bonds			Stocks		
	Purchases	Sales	Net	Purchases	Sales	Net
1983	$22,905	$10,400	$12,505	$2,106	$1,445	$661
1984	56,348	29,575	26,773	1,570	1,519	51
1985	291,338	237,859	53,479	5,484	4,489	995
1986	1,346,989	1,253,965	93,024	20,917	13,869	7,048
1987	1,273,829	1,200,944	72,885	70,936	54,062	16,874
1986:I	251,591	234,330	17,261	2,793	1,961	832
1986:II	368,271	343,467	24,804	3,717	2,260	1,457
1986:III	357,331	330,980	26,351	6,481	4,473	2,008
1986:IV	369,796	345,188	24,608	7,926	5,175	2,751
1987:I	377,850	354,648	23,202	13,925	9,386	4,539
1987:II	341,880	316,585	25,295	15,277	9,797	5,480
1987:III	325,517	308,421	17,096	21,882	18,370	3,512
1987:IV	228,582	221,290	7,292	19,852	16,509	3,343
1988:I	332,047	318,877	13,170	18,901	19,467	-566
1988:II (p)	401,293	374,371	26,922	20,518	20,643	-125

Figuring out what will happen to Japanese portfolio investment abroad is harder. Purchases of foreign government and corporate bonds -- mainly American instruments, brokers believe -- hit a new quarterly high in the April-June period (see Table 2), thanks in large part to the dollar's stability. Japanese investors also unloaded an unprecedented amount of foreign fixed-income securities in the quarter, but the net figure still was a record. That record could be short-lived if the dollar continues to look strong over the short run and U.S. interest rates firm following the Federal Reserve Board's August 9 hike in the discount rate.

Susan MacKnight

Takeshita Prepares For China

The tenth anniversary of the China-Japan Peace and Friendship Treaty will provide a backdrop for Prime Minister Noboru Takeshita's August 25-30 trip to China. The planned celebration will not mask the handful of contentious issues Mr. Takeshita must address. The bilateral situation is hardly dire, however, and both sides can point to positive developments.

The bilateral trade balance threatens to resurface as an issue as it has swung back in Japan's favor. While Japan ran up a $497.7 million trade deficit with China over the first six months of 1987, it has accumulated a $643.5 million surplus in the same period this year (see Table). The turnaround is due to an expansion in exports and a reduction in imports, although the change is hidden in the dollar-denominated data by the sharp appreciation of the yen. When viewed in yen terms, exports rose 13.9 percent to Y589.1 billion in the first half of 1988; concurrently, imports from China fell 16.7 percent to Y483 billion. Whatever the currency, however, the total volume of bilateral trade declined -- by 2.3 percent in yen terms and 16.3 percent on a dollar basis.

Japan's Trade with China, January-June 1987 and 1988

a. in thousands of dollars

	Exports		Imports		Total	
Year	Value	Change	Value	Change	Value	Change
1987	$4,088,488	-13.8%	$4,586,210	16.1%	$8,674,698	-2.3%
1988	3,953,126	-3.3	3,309,657	-27.8	7,262,783	-16.3

b. in millions of yen

1987	Y517,382	-29.1%	Y579,613	-7.5%	Y1,096,995	-20.8%
1988	589,107	13.9	482,984	-16.7	1,072,091	-2.3

Source: Ministry of Finance

China remains unhappy about access to the Japanese market and claims that exports of textiles and other light manufactures have been actively impeded by Tokyo. Japanese export restrictions to stop the outflow of militarily

sensitive products and technology to communist countries also irritate Beijing, although Tokyo is moving to expand its list of permissible exports and streamline export approval procedures. In an overall sense, both sides are unhappy that total bilateral trade has fallen since both nations' global trade volumes are up. Harmonious trade relations allow other issues to be addressed; trade frictions complicate apparently simple issues.

The continuing disagreement over the ownership of a student dormitory in Japan is an example. The government on Taiwan, which bought the facility in 1952, tried to evict eight mainland Chinese residents in the mid-1970s, initiating a legal dispute between Taiwan and China in the Japanese courts. After the Osaka high court's February 26, 1987 affirmation of a 1977 lower court ruling in favor of Taiwan, Beijing protested directly to Tokyo, calling the decision a violation of the 1972 Sino-Japan joint communique normalizing relations and the 1978 peace and friendship treaty. Tokyo pleaded that it could not force the court to rescind its ruling due to the constitutional separation of powers. This, from Japan's viewpoint, was the end of the matter. In an August 4 article in a Chinese journal distributed overseas, however, a Chinese scholar blasted this reasoning as a "pretext," and claimed that Tokyo had effectively adopted a "two Chinas" or "one China, one Taiwan" policy. Coming just before Mr. Takeshita's visit, the article is interpreted as a warning that the issue will be raised during the trip.

Another political issue that almost surely will be raised is the continuing disagreement over whether Japanese cabinet ministers should make an official visit to the Yasukuni shrine commemorating Japanese war dead. Eight war criminals are among the thousands memorialized at the Yasukuni shrine. Former Prime Minister Yasuhiro Nakasone was strongly criticized by China and other Asian nations when he officially paid his respects there in 1985. Mr. Nakasone did not repeat his official visit, a stance adopted by Mr. Takeshita. However, the deputy prime minister, Kiichi Miyazawa, and at least seven other cabinet ministers have announced that they will pay homage at Yasukuni as private citizens during this year's August 15 services commemorating the Japanese surrender. That Mr. Takeshita will allow this and that he failed to quickly disown intemperate remarks by his former Land Agency director general about the Sino-Japanese war (see JEI Report No. 20B, May 20, 1988) does not sit well with Chinese officials. Their unhappiness will surely be made known to the prime minister.

On the brighter side, Mr. Takeshita will bring with him a massive new aid package for his hosts. Beijing had proposed a package of Y916.5 billion ($7.4 billion at Y125=$1.00) for 55 projects for the FY 1991-FY 1995 period. After months of talks, Tokyo will extend approximately Y800 billion ($6.4 billion) for some 40 projects. This is the largest yen-loan program yet; Y200 billion ($1.6 billion) was lent in the FY 1980-FY 1983 period and another Y470 billion ($3.8 billion) is earmarked for the FY 1984-FY 1990 time frame. Although some of the projects will be carryovers from the current program, a number of new ones have been added, including transportation modernization and the development of Hainan island.

In addition, the Foreign Ministry announced July 26 that a Y191.5 billion ($1.5 billion) line of credit will be arranged during the current fiscal year for Chinese modernization projects. The loans are a component of Prime

Minister Nakasone's $30 billion plan to recycle Japan's external surplus to developing countries. The Overseas Economic Cooperation Fund will provide two yen loans of Y91.5 billion ($732 million) and Y70 billion ($560 million); the Export-Import Bank of Japan will provide the remaining Y30 billion ($240 million) in bank loans. The OECF loans are repayable in 30 years (including a 10-year grace period) at an interest rate of 2.5 percent. The new packages will confirm China's place as the largest recipient of Japanese aid.

Tokyo is also urging private businesses to increase their direct investment in China, and Beijing is taking steps to improve the investment climate. Although Japanese direct investment jumped to $1,226 million in FY 1987 from $226 million in the previous fiscal year, Japan accounts for only 8.7 percent of total foreign direct investment in China (as of the end of 1987). Moreover, investment in non-oil areas was stagnant in 1987. Embarrassed by the reluctance of Japanese businessmen, Tokyo has been holding investment promotion tours, touting China's lower costs (in comparison to Taiwan and South Korea) and even encouraging medium- and small-sized firms to consider taking the plunge. Beijing has just announced that it will accord Japanese investment projects national treatment, putting them on a equal basis with purely domestic firms. While at least 20 other nations have agreements with Beijing to protect their investments, only Japan has been given this special treatment. To insure that implementation proceeds smoothly, a joint committee will be formed to oversee its operation. This special status will be included in an accord to be signed during Mr. Takeshita's visit.

Both Chinese and Japanese officials are eagerly awaiting the prime minister's trip. While the majority of the visit will undoubtedly be friendly, Mr. Takeshita is aware that his Chinese hosts have some serious concerns.

Jon Choy

Trade Bill Sent To President

Passage of the more than 1,000-page omnibus trade bill marks what many analysts are calling the largest revision of U.S. trade policy since the end of World War II. Designed to strengthen the U.S. economy and to combat unfair foreign trade practices, the trade bill (HR 4848) was approved by the Senate August 3 by an overwhelming vote of 85-11. The House had passed the bill in mid-July by a margin of 376-45. President Reagan has said that he will sign the bill into law even though he vetoed a similar version of the bill (HR 3) earlier this year (see JEI Report No. 21B, May 27, 1988).

Japanese government officials and business leaders have expressed concerns over the bill because they fear it could adversely impact free trade. After passage of the bill, Tokyo reserved the right to take the United States to the General Agreement on Tariffs and Trade to determine whether the legislation violates the international trade organization's multilateral trade principles. In particular, government and industry worry about the bill's retaliatory provisions.

Several aspects of the trade bill specifically affect Japan. First there are the sanctions against Toshiba Machine Co., Ltd. and parent Toshiba Corp.